

**Announcement: Moody's affirms Baa3/(P)P-3 ratings of Landsvirkjun;
negative outlook**

Global Credit Research - 23 Mar 2012

London, 23 March 2012 -- Moody's Investors Service has today affirmed the Baa3 senior unsecured ratings of Landsvirkjun. Concurrently, Moody's has affirmed the company's provisional (P)Baa3 senior unsecured euro medium-term note (EMTN) programme rating and (P)Prime-3 (P-3) short-term rating. The outlook on the ratings remains negative.

RATINGS RATIONALE

Given Landsvirkjun's 100% direct and indirect ownership by the state, Moody's considers the company to be a government-related issuer. Therefore, its rating is determined by an assessment of its standalone credit quality (expressed as a baseline credit assessment, or "BCA"), and factors pertaining to the likelihood of extraordinary support being provided by the Government of Iceland (Baa3, negative outlook).

The Baa3 rating of Landsvirkjun attributes very high support to the company from the Icelandic government given its guarantee of collection. Moody's assessment of very high support is reinforced by the strategic importance of Landsvirkjun to Iceland, given the company's position as the country's dominant electric utility. This assessment also reflects the significant role played in the economy by the aluminium smelting industry in Iceland, which relies in large part on the electricity provided by Landsvirkjun. Accordingly, the current ratings of Landsvirkjun are on a par with the local and foreign currency bond ratings of the sovereign debt of the Government of the Republic of Iceland.

Moody's notes a number of amendments to the Act on Landsvirkjun with regard to the guarantee of collection enacted in 2011. The revised law states that Landsvirkjun must now apply for a guarantee from its owners on a case by case basis and that only financial obligations can benefit from such guarantees. Previously the guarantee of collection benefitted all creditors and no specific applications were required. However, the state's guarantees of the company's financial liabilities and long-term power contracts entered into before the amendment are unaffected.

The terms of the USD2.5 billion EMTN programme allow for issuance of notes only with the benefit of a guarantee of collection provided by the Republic of Iceland and Eignarhlutir ehf. Despite the fact that a guarantee of collection is not a timely payment guarantee, Moody's believes that there are strong incentives for the owners to provide timely support to Landsvirkjun. However, if the terms of the programme were to be changed such that the company were able to issue notes without such guarantees, such notes may not benefit from the same rating.

As part of this rating action, Moody's has raised Landsvirkjun's BCA to 14 (equivalent to B1) from 15 (equivalent to B2). This reflects the company's strengthened financial profile following its completion of a major investment programme and strong cash flow generation in conjunction with an improved liquidity profile. Landsvirkjun remains exposed to aluminium prices through its contracts with power-intensive industries, and its average cost of debt is likely to rise as debt raised some years ago matures and is refinanced. However, the company is now better positioned to withstand the volatility in the commodity markets given its reduced capital spending and relatively well-spread debt maturity profile.

More specifically, the B1 BCA of Landsvirkjun factors in its dominant position in the Icelandic energy market, supported by the company's low-cost renewable generation asset base, albeit in a small and isolated market. However, the rating is constrained by (i) Landsvirkjun's still high financial leverage; (ii) exposure to aluminium prices in a weak commodity market; (iii) concentrated exposure to a comparatively small number of counterparties in the aluminium industry; (iv) currency risk; and (v) vulnerability to increases in funding costs in the event of higher interest rates.

The negative outlook on the ratings of Landsvirkjun reflects the negative outlook on the Icelandic government's ratings.

WHAT COULD CHANGE THE RATING UP/DOWN

Given the current negative outlook, Moody's does not expect upward rating pressure in the intermediate term. The outlook could return to stable if the outlook on the sovereign rating was changed to stable and there were no changes to the rating agency's view of support assumptions incorporated in the current assessment of Landsvirkjun.

Moody's would expect to downgrade the rating (i) following a downgrade of the sovereign rating; (ii) if it were to perceive that there were a reduced likelihood of the government providing timely support to Landsvirkjun.

PRINCIPAL METHODOLOGIES

The methodologies used in this rating were Unregulated Utilities and Power, published in August 2009, and Government-Related Issuers: Methodology Update, published in July 2010. Please see the Credit Policy page on www.moody.com for a copy of these methodologies.

Headquartered in Reykjavik, Landsvirkjun is Iceland's largest electric utility. It owns the majority of the transmission grid and is responsible for about 75% of Iceland's total electricity production of 17 terawatt hours (TWh). It provides energy for domestic users via sales of electricity to public utilities, although the bulk of sales are to power-intensive industries for aluminium smelting. This forms an important source of Iceland's foreign currency earnings. In 2011, Landsvirkjun's revenues amounted to USD436 million.

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Joanna Fic
Asst Vice President - Analyst
Infrastructure Finance
Moody's Investors Service Ltd.
One Canada Square
Canary Wharf
London E14 5FA
United Kingdom
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

Andrew Blease
Senior Vice President
Infrastructure Finance
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

Releasing Office:
Moody's Investors Service Ltd.
One Canada Square
Canary Wharf
London E14 5FA
United Kingdom
JOURNALISTS: 44 20 7772 5456



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